In the Supreme Court of the United States

OCTOBER TERM, 1924

HENRY P. KEITH, LATE COLLECTOR OF United States Internal Revenue for the First Collection District of New York, petitioner

v.

EMMA B. JOHNSON, AS ADMINISTRATRIX of the Goods, Chattels, and Credits Which Were of John B. Johnson, Deceased

No. ——

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

The Solicitor General of the United States on behalf of Henry P. Keith, individually and as Late Collector of United States Internal Revenue for the First Collection District of New York, prays for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered on November 28, 1924, affirming the judgment of the District Court of the United States for the Eastern District of New York against the petitioner and in favor of the respondent for the sum of $30,985.53, with interest from May 31, 1918, and costs.

32338—25——1

STATEMENT OF THE CASE

The complaint filed in this action shows that John B. Johnson died March 24, 1917, a resident of Kings County, New York. He left a large estate, upon which the net taxable income accrued between the date of his death and December 31, 1917, amounted to $164,958. The Federal Income Tax upon this income amounted to $30,985.53. The Administratrix during the period from March 24, 1917, to December 31, 1917, paid the following inheritance taxes:

June 27, 1917, to State of Colorado	$286.72
June 29, 1917, to State of West Virginia	232.59
Sept. 4, 1917, to State of Kentucky	208.24
Sept. 20, 1917, to State of New York	233,044.20
Sept. 20, 1917, to State of New Jersey	39,201.18
Total	273,092.94

The Administratrix also paid to the State of New York on September 21 and 22, 1917, a tax on bonds belonging to the estate in the amount of $1,145.00.

The Commissioner of Internal Revenue did not permit the deduction of any of the amounts so paid as "taxes paid during the taxable year."

The Administratrix on or about the 28th day of March, 1918, filed an income tax return for the estate of John B. Johnson covering the period beginning at the time of his death, March 24, 1917, and ending December 31, 1917. Although contending in this return that the above-mentioned inheritance taxes were deductible, the Administratrix, complying with the regulations of the Commissioner, did not take the deductions. She paid an

income tax amounting to $30,985.53. This payment is alleged to have been made under protest and duress. Thereafter a claim for refund was filed in which it is set out that the amount of inheritance taxes paid is deductible and that since this payment is more than the entire income of the estate no income tax accrued. The Commissioner of Internal Revenue rejected this claim on the ground that the inheritance taxes were not deductible, whereupon the plaintiff instituted this suit for the recovery of the entire amount of income tax paid.

The propriety of deducting the inheritance taxes paid to States other than New York and the propriety of deducting the tax on bonds is not in issue in this case, the parties having stipulated—

> that the only question to be decided was whether a transfer tax paid to the State of New York is such a tax as should properly have been allowed as a deduction in computing the net income of the estate of John G. Johnson, deceased, for the period beginning March 24, 1917, and ending December 31, 1917, under the provisions of the Revenue Act of 1916, as amended, and the Revenue Act of 1917, and any other United States Revenue Laws, if any, in force and bearing upon the question at the time mentioned in the complaint.

The defendant demurred, the District Court overruled the demurrer, and upon failure of the defendant to answer over entered judgment against him in favor of the plaintiff. The defendant there-

upon sued out from the Circuit Court of Appeals for the Second Circuit his writ of error to the District Court. The Circuit Court of Appeals affirmed the judgment of the District Court, wherefore the defendant, plaintiff in error in the former court, petitions this Court to grant him a writ of certiorari.

QUESTION PRESENTED

Are transfer taxes paid to the State of New York deductible for Federal Income Tax purposes from the gross income of a decedent's estate in the process of settlement under the provisions of Section 5 (a) (3) of the Revenue Act of 1916, as amended by Section 1201 of the Revenue Act of 1917?

STATUTES INVOLVED

Section 2 (b) of the Revenue Act of 1916 (39 Stat. 756, 757) provides:

> Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, and the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed

to the executor, administrator, or trustee, as the case may be: *Provided,* That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries.

Section 5 (a) (3) of the Revenue Act of 1916 (39 Stat. 756, 759), as amended by Section 1201 of the Revenue Act of 1917 (40 Stat. 300, 330), provides:

SEC. 5. That in computing net income in the case of a citizen or resident of the United States—

(a) For the purpose of the tax there shall be allowed as deductions—

Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes) or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

The pertinent provisions of the New York Transfer Tax Law and of the regulations promulgated thereunder are set out in the Appendix.

REASONS FOR GRANTING THE PETITION

1. Although this Court has held in the case of *New York Trust Company* v. *Eisner*, 256 U. S. 345, that the transfer tax imposed by the State of New York is not deductible from a decedent's gross estate for Federal Estate Tax purposes because it is not a charge against that Estate, the judgment of the Circuit Court of Appeals in this case is based upon the conclusion that the transfer tax *is* a charge against the decedent's estate.

2. The Circuit Court of Appeals departs from the rule established by this Court, and other courts, that the Revenue Act of 1916 creates for income tax purposes a taxable entity upon which the Federal Income Tax is imposed.

3. The right to deduct inheritance taxes paid from the gross income of an estate in the process of settlement is a right claimed by every taxable estate and the principle involved is not restricted to taxes imposed by the State of New York. The question is, therefore, one of great general importance, and affects the rights of a great number of taxpayers as well as a great amount of Governmental revenue. Ordinarily the inheritance taxes imposed by the States are in such large amounts that they are greater than the income of the Estate for any one year. Ordinarily decedents' estates

are in process of settlement for only one year. The result is, therefore, that under the rule established by the Circuit Court of Appeals the provisions of the Federal Act imposing a tax upon the income received by Estates in the process of administration are nullified.

4. The rule laid down by the Circuit Court of Appeals is expressly restricted by the Court to such taxes as are imposed by the State of New York upon distributive shares. It is not applied to such taxes when levied upon devises, inheritances, or specific bequests. Whether it applies to general legacies is not determined. The rule, therefore, in many cases requires the allocation of the tax between several gifts to the same beneficiary. But the tax is levied (except in certain cases where an amendment of the Act changes the rate after a taxable transfer, e. g., a transfer in contemplation of death, has been made) at a graded rate upon the aggregate value of all the gifts to that beneficiary above exemption. It is, therefore, impossible in many cases to allocate the tax as required by the rule, so that, as a practical matter, it can not in many cases be followed.

Moreover, the statutes of New York impose the same tax and the same kind of a tax upon inheritances, devises, and specific bequests as is imposed upon general bequests and distributive shares. In all cases the tax is payable in the same way, through the same person (the personal representative), and by the same person (the beneficiary).

The rule is not only difficult, and in many cases, impossible, of application, but also it is arbitrary and inconsistent.

5. The question involved will be later presented to this Court in a writ of error directed to the United States District Court for the Southern District of New York in the case of *Farmers' Loan & Trust Company, Executor of Seligman,* v. *United States,* and in appeals from the Court of Claims in *Farmers' Loan & Trust Company, Executor of George Arents,* v. *United States;* and *Charles E. Hermann, Executor of Dellora R. Gates,* v. *United States.* If certiorari is not granted in the instant case, the Government will be bound by the judgment, although it may develop that the rule upon which it is founded is wrong.

Wherefore, it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit should be granted.

JAMES M. BECK,
Solicitor General

FEBRUARY, 1925.

BRIEF IN SUPPORT OF THE PETITION

ARGUMENT

The Revenue Act of 1916 provides that " income received by the estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates * * *." (Section 2 (b).) It further provides that in determining the taxable net income of the estate there may be deducted from the gross income of the estate " taxes paid within the year imposed by the authority * * * of any State * * *." (Section 5 (a) (3).) The taxes which are thus deductible from the gross income of the Estate are taxes which are imposed upon the estate for, of course, Congress did not intend to credit against one person's income another person's taxes.

Northern Trust Company v. *McCoach*, 215 Fed. 991, 993;

National Bank of Commerce v. *Allen*, 211 Fed. 743, 746, aff. 223 Fed. 472, 477;

First National Bank v. *McNeel*, 238 Fed. 559, 560;

Elliott National Bank v. *Gill*, 218 Fed. 600, 601.

As this Court said in the case of *United States* v. *Woodward*, 256 U. S. 632, in construing a similar

provision of the 1918 Act relating to the deduction of taxes:

> The words of the major clause are comprehensive and include every tax *which is charged against* the estate by the authority of the United States. (Italic ours.)

The transfer tax imposed by the State of New York is not "charged against the Estate." This Court so said in the case of *New York Trust Company* v. *Eisner*, 256 U. S. 345, at page 350. Mr. Justice Holmes said:

> * * * "Charges against the Estate," as pointed out by the court below, are only charges that effect the estate as a whole, and, therefore, do not include taxes on the right of individual beneficiaries. This reason excludes not only the New York Succession Tax, but those taxes paid to other States which can stand no better than that paid in New York. * * *

The mere fact that the Executor is required to pay both the income tax and the New York Transfer Tax does not indicate that he is the "taxpayer" in any substantial sense. His liability to pay extends only to the value of the assets in his hands or his ability otherwise to recoup his payments from the real taxpayer. He is merely a collection agent for the sovereign.

New York Trust Company v. *Eisner*, 263 Fed. 620.

In re Gibon, 169 N. Y. 438.

Sherman v. *Moore*, 89 Conn. 190.

In the *New York Trust Company case, supra,* the learned District Judge said (p. 622):

> Estate taxes or probate duties levied by the State would fall within this clause. * * * But taxes levied on the shares to be received by beneficiaries, reducing not the estate, but the individual's share, can not be deemed a charge upon the estate merely because the duty, with the corresponding liability and right to account in respect thereto in his estate accounts, is imposed upon the executor or administrator to pay the tax before distributing the share itself.

The Federal Income Tax is imposed upon the Estate, the Act (Section 2 (b)) specifically providing that the tax shall be "taxed to their Estate." The statute looks to the Estate as a whole, although it may be in the hands of several representatives in several jurisdictions. For the purposes of identification it is true the statute permits the assessment in the name of the personal representative, and he is required to see that the tax is paid, but there is no personal liability except he fail to apply the assets of the Estate to the payment of the tax. (Revised Statutes, Sections 3166, 3167.) The statute looks to the *res* and treats that *res* as a taxable entity.

Merchants Loan & Trust Company v. *Smietanka,* 255 U. S. 509;

Catherwood v. *United States,* 280 Fed. 241;

Billings v. *State,* 107 Ind. 54.

So the Federal Estate Tax is imposed upon the Estate.

United States v. *Woodward,* 256 U. S. 632;

New York Trust Co. v. *Eisner,* 256 U. S. 345.

In this respect both Federal Taxes are different from the New York Transfer Tax, which is either imposed upon the Executor, as the court below said it was, following *Home Trust Company* v. *Law,* 198 N. Y. S. 710, affirmed without opinion, 236 N. Y. 607, or is imposed upon individual shares of the legatees.

See:

Re Vanderbilt, 10 N. Y. S. 239;

Re Garcia, 170 N. Y. S. 980;

Re Hacket, 35 N. Y. S. 1051.

Re Hubbard, 48 N. Y. S. 869;

New York Transfer Tax Laws, Sections 224, 226 (McKinney's Consolidated Laws of New York, Book 59).

In either event it is not imposed upon the person or estate or entity, whatever it may be called, that is required to pay and does pay the Federal Income Tax. It, consequently, is not properly deducted from the gross income of that taxpayer under the provisions of Section 5(a)(3) of the Revenue Act of 1916.

CONCLUSION

It is the opinion of the Government that the Circuit Court of Appeals for the Second Circuit has erred in deciding a question of great general

importance affecting a large number of taxpayers and a large amount of governmental revenue. The rule laid down by the court can not, in practice, be followed because it is in many cases impossible for the administrative officers to determine what part, if any, of the New York Tax is levied upon distributive shares or general legacies. The judgment of the court below is admittedly predicated upon a disregard of the reasoning of this Court in similar cases. The result is an "unworkable" rule permitting the deduction of a part only of a State tax, the part being dependent upon the nature of the property transferred, and the form of the transfer, although the State law in imposing the tax makes no such distinction. For these reasons it is respectfully submitted that the writ prayed for should issue.

JAMES M. BECK,
Solicitor General.

FEBRUARY, 1925.

APPENDIX

The following excerpts from Article 10 of the New York State Tax Law (Chapter 62, Laws of 1909, as amended) are pertinent to the inquiry in this case:

> SEC. 220. A tax shall be and is hereby imposed upon the transfer of any property real or personal, or of any interest therein or income therefrom in trust or otherwise to persons or corporations in the following cases. (The section then describes the various transfers which are taxable.)

Section 221 provides certain exemptions in the case of gifts to charitable organizations, etc., and to certain relatives.

> SEC. 221 (a) *Rates of tax.*—1. Upon all transfers taxable under this article of property or any beneficial interest therein in excess of the value of five thousand dollars to any father, mother, husband, wife, or child of the decedent, grantor, bargainor, donor, or vendor, or to any child adopted as such in conformity with the laws of this state, of the decedent, grantor, bargainor, donor, or vendor, or upon all transfers taxable under this article of property or any beneficial interest therein in excess of the value of five hundred dollars to any lineal descendant of the decedent, grantor, bargainor, donor, or vendor, born in lawful wedlock, the tax on such transfers shall be at the rate of
>
> One per centum on any amount up to and including the sum of twenty-five thousand dollars;

Two per centum on the next seventy-five thousand dollars or any part thereof;

Three per centum on the next one hundred thousand dollars or any part thereof;

Four per centum on the amount representing the balance of each individual transfer.

(Subdivisions 2 and 3 of Section 221 (a) provide for a like graded tax in the case of other classes. If the transfer is to a brother, sister, wife, and others the rates vary from two per cent to five per cent. If the transfer is to any other person the rates vary from five per cent to eight per cent.)

Section 221 (b) provides for an additional tax on investments in certain cases.

Section 221 (c) provides the rule for fixing a tax upon transfers from non-resident decedents.

Section 221 (d) provides for an optional method of commutation of tax on non-resident estates.

Section 222 provides for the accrual and time of payment of the tax.

Section 223 provides for discount and interest.

SEC. 224. *Lien of tax and collection by executors, administrators, and trustees.*— Every such tax shall be and remain a lien upon the property transferred until paid and the person to whom the property is so transferred, and the executors, administrators and trustees of every estate so transferred shall be personally liable for such tax until its payment. Every executor, administrator, or trustee shall have full power to sell so much of the property of the decedent as will enable him to pay such tax in the same manner as he might be entitled by law to do for the payment of the debts of the testator or intestate. Any such executor, ad-

ministrator, or trustee having in charge or in trust any legacy or property for distribution subject to such tax shall deduct the tax therefrom and shall pay over the same to the tax commission or county treasurer, as herein provided. If such legacy or property be not in money, he shall collect the tax thereon upon the appraised value thereof from the person entitled thereto. He shall not deliver or be compelled to deliver any specific legacy or property subject to tax under this article to any person until he shall have collected the tax thereon. If any such legacy shall be charged upon or payable out of real property, the heir or devisee shall deduct such tax therefrom and pay it to the executor, administrator, or trustee, and the tax shall remain a lien or charge on such real property until paid; and the payment thereof shall be enforced by the executor, administrator, or trustee in the same manner that payment of the legacy might be enforced, or by the district attorney under section two hundred and thirty-five of this chapter. If any such legacy shall be given in money to any such person for a limited period, the executor, administrator, or trustee shall retain the tax upon the whole amount, but if it be not in money, he shall make application to the court having jurisdiction of an accounting by him to make an apportionment, if the case require it, of the sum to be paid into his hands by such legatees, and for such further order relative thereto as the case may require.

Section 225 provides that in case a legacy is decreased by reason of the payment of debts the amount of tax paid shall be refunded by the executor or by the tax commission to the legatee.

Section 226 provides for taxes upon devises and bequests in lieu of commissions.

Section 227 provides that trust companies and other transfer agents shall be liable for the payment of the tax in certain cases.

Sections 228 to 242, inclusive, provide the procedure for the assessment and collection of the tax.

Section 243 defines the various terms used in the statute.

Sections 244 and 245 make the provisions of the general tax law of the State inapplicable to the transfer taxes.

The following are the pertinent provisions of the New York State Inheritance Tax Regulations promulgated under the above law:

> ARTICLE 12. *Incidence of the tax.*—The tax is imposed upon the transfer to each beneficiary and computed upon the amount passing to each such beneficiary. The amount of tax is determined by the value of the property transferred to each beneficiary and the relationship of the beneficiary to the transferor; it is not affected by the tax imposed upon any other beneficiary or by the exemption allowed to any other beneficiary, nor is it affected by the fact that the beneficiary is a nonresident or outside the jurisdiction of this State. If the property transferred consists of bonds of the several States or political subdivisions thereof, or of the United States, or if a legacy is payable from the proceeds of the sale of such bonds, the tax is nevertheless imposed, and whether or not such bonds are designated as tax exempt makes no difference.

ARTICLE 13. *Measure of tax.*—The tax is measured by the value of the interest of each beneficiary, which is determined by ascertaining the amount of such interest at the date of the transfer after deducting from the gross estate the amounts allowable for funeral expenses, debts, administration expenses, etc., as hereinafter set forth in Articles 151, et seq. The sum of all transfers to any one beneficiary taking effect at the same time is used in determining the amount of tax. If a beneficiary receives a specific bequest and a share of the residuary estate in addition, the value of both is added and the tax imposed on the total amount.

A transfer of property during the lifetime of the transferor with reservation of a life estate in him is taxable at the date of the transfer if there is no power of revocation reserved and no contingency under which the remainder may revert. Property so transferred is taxed separately from a transfer to the same beneficiary at death, and the statutory exemption is to be allowed in respect to each of the transfers. Where, however, a transfer is made during the lifetime of the transferor which does not become absolute until his death and the transferee is also entitled to a share of the transferor's estate under his will, or the intestate laws, the two transfers merge and are treated together in determining the amount of tax.